

AMENDED IN SENATE AUGUST 19, 2010  
AMENDED IN SENATE AUGUST 16, 2010  
AMENDED IN SENATE AUGUST 5, 2010  
AMENDED IN SENATE JUNE 16, 2010  
AMENDED IN SENATE MAY 27, 2010  
AMENDED IN ASSEMBLY JANUARY 25, 2010  
AMENDED IN ASSEMBLY JANUARY 13, 2010  
AMENDED IN ASSEMBLY JANUARY 6, 2010  
AMENDED IN ASSEMBLY JANUARY 4, 2010  
CALIFORNIA LEGISLATURE—2009–10 REGULAR SESSION

## **ASSEMBLY BILL**

**No. 1178**

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**Introduced by Assembly Member Portantino**

February 27, 2009

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An act to amend Sections 17215, 17220, ~~19774~~, and 23701i of, and to add Sections 17131.7, 17131.9, 17131.10, 17131.11, 17131.12, 17131.13, 17131.14, 17134.1, 17201.1, 17222.1, 24343.6, and 24345.1 to, the Revenue and Taxation Code, relating to taxation, to take effect immediately, tax levy.

### LEGISLATIVE COUNSEL'S DIGEST

AB 1178, as amended, Portantino. Income taxes: federal conformity: Patient Protection and Affordable Care Act: Health Care and Education Reconciliation Act of 2010.

The Personal Income Tax Law and the Corporation Tax Law, in specified conformity with federal income tax laws, provide certain gross income exclusions, impose specified tax rates, and allow various deductions and credits in computing the income that is subject to the taxes imposed by those laws, as specified.

This bill would, under both laws, provide additional conformity with federal income tax laws by adopting specified provisions of the Patient Protection and Affordable Care Act and the Health Care and Education Reconciliation Act of 2010 relating to gross income exclusions for reimbursements for medical care expenses under specified plans for dependents, Indian health care benefits, free choice vouchers, participants in the National Health Service Corps, student loan repayments, adoption assistance, therapeutic discovery project credits, annual fees on branded prescriptions, unreimbursed medical expenses, hospital insurance tax, cafeteria plans, ~~the economic substance doctrine and related penalties~~, and tax rates on distributions from a nonqualified medical savings accounts, as specified.

This bill would take effect immediately as a tax levy.

Vote: majority. Appropriation: no. Fiscal committee: yes.  
State-mandated local program: no.

*The people of the State of California do enact as follows:*

- 1 SECTION 1. Section 17131.7 is added to the Revenue and
- 2 Taxation Code, to read:
- 3 17131.7. (a) Section 105(b) of the Internal Revenue Code,
- 4 relating to amounts expended for medical care, as amended by
- 5 Section 1004(d)(1) of the Health Care and Education Reconciliation
- 6 Act of 2010 (Public Law 111-152), shall apply, except as otherwise
- 7 provided.
- 8 (b) This section shall apply in the same manner and to the same
- 9 periods as the federal amendments referred to in subdivision (a)
- 10 apply for federal purposes, except as otherwise provided.
- 11 SEC. 2. Section 17131.9 is added to the Revenue and Taxation
- 12 Code, to read:
- 13 17131.9. For taxable years beginning on or after January 1,
- 14 2011, Section 106(f) of the Internal Revenue Code, relating to
- 15 reimbursements for medicine restricted to prescribed drugs and
- 16 insulin, as added by Section 9003(c) of the Patient Protection and

1 Affordable Care Act (Public Law 111-148), shall apply, except as  
2 otherwise provided.

3 SEC. 3. Section 17131.10 is added to the Revenue and Taxation  
4 Code, to read:

5 17131.10. (a) For taxable years beginning on or after January  
6 1, 2014, Section 125(f) of the Internal Revenue Code, relating to  
7 qualified benefits defined, as amended by Section 1515 of the  
8 Patient Protection and Affordable Care Act (Public Law 111-148),  
9 shall apply, except as otherwise provided.

10 (b) For taxable years beginning on or after January 1, 2013,  
11 Section 125(i) of the Internal Revenue Code, relating to limitation  
12 on health flexible spending arrangements, as added by Section  
13 9005 of the Patient Protection and Affordable Care Act (Public  
14 Law 111-148) and amended by Section 10902 of the Patient  
15 Protection and Affordable Care Act (Public Law 111-148) and  
16 Section 1403 of the Health Care and Education Reconciliation Act  
17 of 2010 (Public Law 111-152), shall apply, except as otherwise  
18 provided.

19 (c) For taxable years beginning on or after January 1, 2011,  
20 Section 125(j) of the Internal Revenue Code, relating to simple  
21 cafeteria plans for small businesses, as added by Section 9022 of  
22 the Patient Protection and Affordable Care Act (Public Law  
23 111-148), shall apply, except as otherwise provided.

24 SEC. 4. Section 17131.11 is added to the Revenue and Taxation  
25 Code, to read:

26 17131.11. For taxable years beginning on or after January 1,  
27 2010, Section 137 of the Internal Revenue Code, relating to  
28 adoption assistance programs, as amended by Section 10909(a)(2)  
29 of the Patient Protection and Affordable Care Act (Public Law  
30 111-148), shall apply, except as otherwise provided.

31 SEC. 5. Section 17131.12 is added to the Revenue and Taxation  
32 Code, to read:

33 17131.12. (a) Section 139D of the Internal Revenue Code,  
34 relating to Indian health care benefits, as added by Section 9021  
35 of the Patient Protection and Affordable Care Act (Public Law  
36 111-148), shall apply, except as otherwise provided.

37 (b) This section shall apply to benefits and coverage provided  
38 after March 23, 2010.

39 (c) No inference shall be made with respect to the enactment  
40 the act adding this section with respect to the exclusion from gross

1 income of benefits provided by either an Indian tribe or tribal  
2 organization that are not within the scope of this section or were  
3 provided prior to March 23, 2010.

4 SEC. 6. Section 17131.13 is added to the Revenue and Taxation  
5 Code, to read:

6 17131.13. For taxable years beginning on or after January 1,  
7 2014, Section 139D of the Internal Revenue Code, relating to free  
8 choice vouchers, as added by Section 10108(f) of the Patient  
9 Protection and Affordable Care Act (Public Law 111-148), shall  
10 apply, except as otherwise provided.

11 SEC. 7. Section 17131.14 is added to the Revenue and Taxation  
12 Code, to read:

13 17131.14. (a) Any grant made in any year by the Secretary of  
14 the Treasury under Section 9023(e) of the Patient Protection and  
15 Affordable Care Act (Public Law 111-148), to a person that places  
16 in service qualified therapeutic discovery project property, shall  
17 not be includable in the gross income or the alternative minimum  
18 taxable income of the taxpayer.

19 (b) This section shall apply in the same manner and to the same  
20 periods as the provisions of federal law referred to in subdivision  
21 (a) apply for federal purposes, except as otherwise provided.

22 SEC. 8. Section 17134.1 is added to the Revenue and Taxation  
23 Code, to read:

24 17134.1. For taxable years beginning on or after January 1,  
25 2010, Section 108(f)(4) of the Internal Revenue Code, relating to  
26 payments under the National Health Service Corps loan repayment  
27 program and certain state loan repayment programs, as amended  
28 by Section 10908 of the Patient Protection and Affordable Care  
29 Act (Public Law 111-148), shall apply, except as otherwise  
30 provided.

31 SEC. 9. Section 17201.1 is added to the Revenue and Taxation  
32 Code, to read:

33 17201.1. (a) Section 162(l)(1) of the Internal Revenue Code,  
34 relating to allowance of deduction, as amended by Section  
35 1004(d)(2) of the Health Care and Education Reconciliation Act  
36 of 2010 (Public Law 111-152), shall apply, except as otherwise  
37 provided.

38 (b) Section 162(l)(2)(B) of the Internal Revenue Code, relating  
39 to other coverage, as amended by Section 1004(d)(3) of the Health

1 Care and Education Reconciliation Act of 2010 (Public Law  
2 111-152), shall apply, except as otherwise provided.

3 (c) This section shall apply in the same manner and to the same  
4 periods as the federal amendments referred to in subdivision (a)  
5 or subdivision (b), respectively, apply for federal purposes, except  
6 as otherwise provided.

7 SEC. 10. Section 17215 of the Revenue and Taxation Code is  
8 amended to read:

9 17215. (a) Section 220(a) of the Internal Revenue Code,  
10 relating to deduction allowed, is modified to provide that the  
11 amount allowed as a deduction shall be an amount equal to the  
12 amount allowed to that individual as a deduction under Section  
13 220 of the Internal Revenue Code, relating to medical savings  
14 accounts, on the federal income tax return filed for the same taxable  
15 year by that individual.

16 (b) For taxable years beginning on or after January 1, 2011,  
17 Section 220(d)(2)(A) of the Internal Revenue Code, as amended  
18 by Section 9003(b) of the Patient Protection and Affordable Care  
19 Act (Public Law 111-148), shall apply, except as otherwise  
20 provided.

21 (c) Section 220(f)(4) of the Internal Revenue Code, relating to  
22 additional tax on distributions not used for qualified medical  
23 expenses, is modified by substituting “10 percent” for “15 percent.”

24 (d) For taxable years beginning on or after January 1, 2011,  
25 Section 220(f)(4) of the Internal Revenue Code, relating to  
26 additional tax on distributions not used for qualified medical  
27 expenses, as amended by Section 9004 of the Patient Protection  
28 and Affordable Care Act (Public Law 111-148), is modified by  
29 substituting “12.5 percent” for “20 percent.”

30 SEC. 11. Section 17220 of the Revenue and Taxation Code is  
31 amended to read:

32 17220. (a) Section 164(a)(3) of the Internal Revenue Code,  
33 relating to the deductibility of state, local, and foreign income, war  
34 profits, and excess profits taxes, shall not apply.

35 (b) Section 164(b)(5) of the Internal Revenue Code, relating to  
36 general sales taxes, shall not apply.

37 (c) In addition to the provisions of Section 164(c) of the Internal  
38 Revenue Code, relating to deduction denied in case of certain  
39 taxes, no deduction shall be allowed for any tax imposed under  
40 Chapter 10.5 (commencing with Section 17935), Chapter 10.6

(commencing with Section 17941), or Chapter 10.7 (commencing with Section 17951) of this part or under Part 11 (commencing with Section 23001).

(d) For taxable years beginning on or after January 1, 2013, Section 164(f) of the Internal Revenue Code, relating to deduction for one-half of self-employment taxes, as amended by Sections 9015(b) and 10906(b) of the Patient Protection and Affordable Care Act (Public Law 111-148), shall apply, except as otherwise provided.

SEC. 12. Section 17222.1 is added to the Revenue and Taxation Code, to read:

17222.1. For taxable years beginning on or after January 1, 2011, no deduction shall be allowed for the fees imposed on manufacturers or importers of branded prescription drugs by Section 9008 of the Patient Protection and Affordable Care Act (Public Law 111-148), as amended by Section 1404 of the Health Care and Education Reconciliation Act of 2010 (Public Law 111-152).

~~SEC. 13. Section 19774 of the Revenue and Taxation Code is amended to read:~~

~~19774. (a) If a taxpayer has a noneconomic substance transaction understatement for any taxable year, there shall be added to the tax an amount equal to 40 percent of the amount of that understatement.~~

~~(b) (1) Subdivision (a) shall be applied by substituting “20 percent” for “40 percent” with respect to the portion of any noneconomic substance transaction understatement with respect to which the relevant facts affecting the tax treatment of the item are adequately disclosed in the return or a statement attached to the return.~~

~~(2) For taxable years beginning before January 1, 2003, “adequately disclosed” includes the disclosure of the tax shelter identification number on the taxpayer’s return as required by subdivision (e) of Section 18628, as applicable for the year in which the transaction was entered into.~~

~~(c) For purposes of this section:~~

~~(1) The term “noneconomic substance transaction understatement” means any amount which would be an understatement under Section 6662A(b) of the Internal Revenue Code, as modified by subdivision (b) of Section 19164.5 if Section~~

1 ~~6662A(b) of the Internal Revenue Code were applied by taking~~  
2 ~~into account items attributable to noneconomic substance~~  
3 ~~transactions rather than items to which Section 6662A(b) applies.~~

4 ~~(2) A “noneconomic substance transaction” includes:~~

5 ~~(A) The disallowance of any loss, deduction or credit, or addition~~  
6 ~~to income attributable to a determination that the disallowance or~~  
7 ~~addition is attributable to a transaction or arrangement that lacks~~  
8 ~~economic substance including a transaction or arrangement in~~  
9 ~~which an entity is disregarded as lacking economic substance. A~~  
10 ~~transaction shall be treated as lacking economic substance if the~~  
11 ~~taxpayer does not have a valid nontax California business purpose~~  
12 ~~for entering into the transaction.~~

13 ~~(B) Any disallowance of claimed tax benefits by reason of a~~  
14 ~~transaction lacking economic substance, within the meaning of~~  
15 ~~Section 7701(o) of the Internal Revenue Code, relating to~~  
16 ~~clarification of economic substance doctrine, as added by Section~~  
17 ~~1409(a) of the Health Care and Education Reconciliation Act of~~  
18 ~~2010 (Public Law 111-152), except as otherwise provided.~~

19 ~~(i) For purposes of this subparagraph, the phrase “apart from~~  
20 ~~state income tax effects” shall be substituted for the phrase “apart~~  
21 ~~from federal income tax effects” in each place it appears in Section~~  
22 ~~7701(o)(1) of the Internal Revenue Code.~~

23 ~~(ii) For purposes of this subparagraph, the phrase “any federal~~  
24 ~~or local income tax effect which is related to a state income tax~~  
25 ~~effect shall be treated in the same manner as a state income tax~~  
26 ~~effect” is substituted for the phrase “any state or local income tax~~  
27 ~~effect which is related to a Federal income tax effect shall be~~  
28 ~~treated in the same manner as a Federal income tax effect” in~~  
29 ~~Section 7701(o)(3) of the Internal Revenue Code.~~

30 ~~(d) (1) If the notice of proposed assessment of additional tax~~  
31 ~~has been sent with respect to a penalty to which this section applies,~~  
32 ~~only the Chief Counsel of the Franchise Tax Board may~~  
33 ~~compromise all or any portion of that penalty.~~

34 ~~(2) The exercise of authority under paragraph (1) shall be at the~~  
35 ~~sole discretion of the Chief Counsel of the Franchise Tax Board~~  
36 ~~and may not be delegated.~~

37 ~~(3) Notwithstanding any other law or rule of law, any~~  
38 ~~determination under this subdivision may not be reviewed in any~~  
39 ~~administrative or judicial proceeding.~~

~~(e) Notwithstanding anything to the contrary in this section, if a penalty has been assessed for federal income tax purposes pursuant to Section 6662(b)(6) of the Internal Revenue Code, as added by Section 1409(a) of the Health Care and Education Reconciliation Act of 2010 (Public Law 111-152), on an underpayment attributable to the disallowance of claimed tax benefits by reason of a transaction lacking economic substance, then a penalty shall be imposed under this section for that portion of an understatement attributable to that transaction, and shall not be abated unless the taxpayer can establish that the imposition of the federal penalty under Section 6662 of the Internal Revenue Code for an underpayment attributable to that transaction was clearly erroneous.~~

~~(f) The amendments made to this section by the act adding this subdivision shall apply to notices mailed on or after the effective date of the act adding this subdivision.~~

~~SEC. 14.~~

*SEC. 13.* Section 23701i of the Revenue and Taxation Code is amended to read:

23701i. (a) A voluntary employees' beneficiary association described in Section 501(c)(9) of the Internal Revenue Code, as amended by Section 1004(d)(4) of the Health Care and Education Reconciliation Act of 2010 (Public Law 111-152).

(b) The amendments made to this section by the act adding this subdivision shall apply in the same manner and to the same periods as the federal amendments referred to in subdivision (a) apply for federal purposes.

~~SEC. 15.~~

*SEC. 14.* Section 24343.6 is added to the Revenue and Taxation Code, to read:

24343.6. For taxable years beginning on or after January 1, 2014, Section 162(a) of the Internal Revenue Code, as amended by Section 10108(f) of the Patient Protection and Affordable Care Act (Public Law 111-148), shall apply, except as otherwise provided.

~~SEC. 16.~~

*SEC. 15.* Section 24345.1 is added to the Revenue and Taxation Code, to read:

24345.1. For taxable years beginning on or after January 1, 2011, no deduction shall be allowed for fees imposed on



1 manufacturers or importers of branded prescription drugs by  
2 Section 9008 of the Patient Protection and Affordable Care Act  
3 (Public Law 111-148), as amended by Section 1404 of the Health  
4 Care and Education Reconciliation Act of 2010 (Public Law  
5 111-152).

6 ~~SEC. 17.~~

7 *SEC. 16.* This act provides for a tax levy within the meaning  
8 of Article IV of the Constitution and shall go into immediate effect.

O